RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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February 24, 1983 **LETTER 855**

Feb. 11, DJIA 1086.50; PTI 1489; A-D ratio –17.23
Feb. 18, DJIA 1092.82; PTI 1498; A-D ratio –17.11

THE MARKET: In this business it pays to try to see what nobody else is seeing. And it pays to have a healthy *disrespect* for most of what you read. Along these lines I read an awful lot of investment reports each week, and yes, I'm aware that many of these reports are pointing to problems in the technical picture. For instance, the put/call ratio is now weighted very heavily on the call side, and this reflects "too much optimism" on the part of option players. By the same token, insider selling is extremely heavy now, and the theory is that when the insiders sell shares in their own companies, those shares are too expensive. Maybe so.

I also know that institutional cash is currently at minimum levels, and this tells us that the ammunition used by the institutional buyers is running low. Then there is the problem of the overload of bullish financial advisers. We're told that around four out of five advisory services are now bullish, and there can't be that many winners.

There is one item that may have escaped the attention of most stock market observers and analysts. Here it is: most of the guys who are writing about or trading stocks have never seen a big primary bull market. Unless you were around during the '50's and early '60's you really don't know what a big bull trend can do. The fact is–it can do anything, and most of all it can drive the bears up the wall, and it can send the analysts who draw conclusions from "normal market action" and "reasonable expectations" into a state of high anxiety.

Now I've been around long enough to expect the market to do the "unexpected". And I know that Wall Street simply adores the idea of taking last year's favorite soothsayers apart, limb by limb, forecast by forecast. In order to make total fools of the forecasters, the stock market has to come up with something totally unexpected, something outrageous. Maybe it's working on that now.

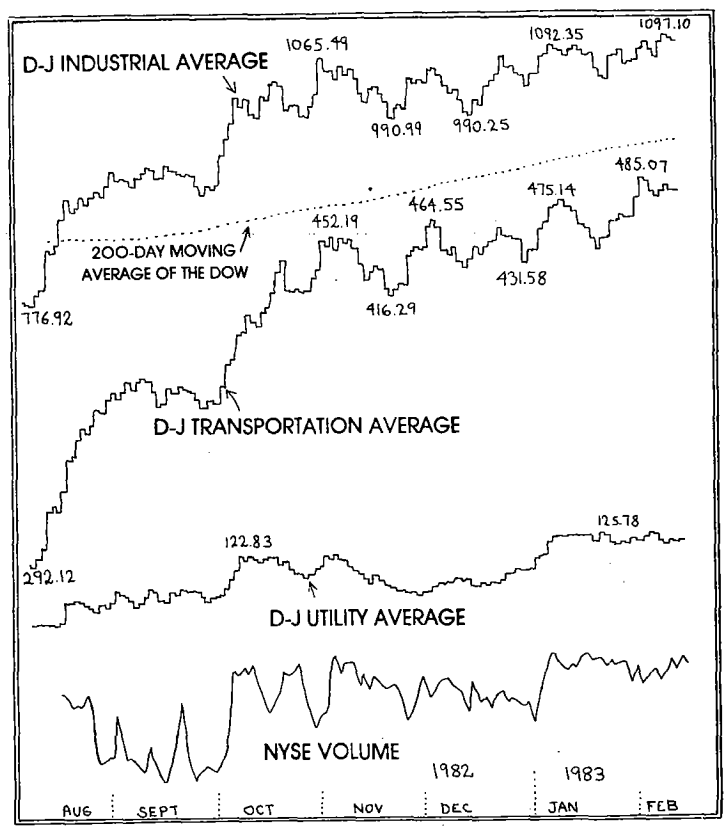
Even the fundamentals seem to be in hair-pulling territory. For instance, there has been a lot of comment on the phenomenon of the price/earnings of the Dow rising from the low of 7.4 in August, 1982 to the current lofty level of 30.7. But the situation is not as bearish as it seems. The fat 30.7 current ratio was brought on by deficit earnings (losses) on the part of Alcoa, Bethlehem Steel, Inco, International Harvester and US Steel. This series of deficits is a product of a severe-recession year, but it does not mean that the Dow (taken as an average) is expensive. In 1932 the accumulated earnings for the Dow dropped to a negative quantity while the P/E for the Dow that year rose to infinity. Yet stocks were cheap, and the 1932 Dow levels were never again seen.

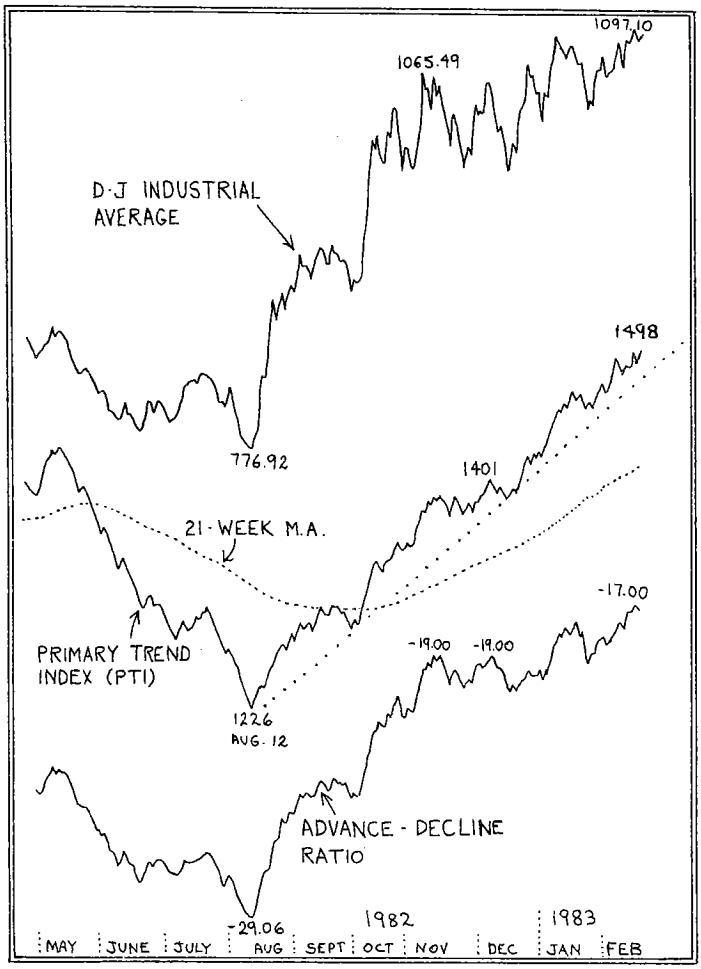
All right, now let's turn to the price action. Last week saw all kinds of record highs–record highs in the NYSE Composite, a record high in the S & P 500 composite, a record high in the Dow Industrials and a record high in the broad D-J 65 Stock Average. Now in all honesty and despite what you may read, that doesn't sound like or smell like an explosive rally in a bear market. No, it looks like typical action in a primary bull market.

Is this market ready to top out–at least on a secondary basis? Honestly, no one knows. But two statistics suggest that the period of intelligent buying has come to an end (in other words, if you have not bought stocks by now, hold off). The first statistic is that the market has moved up for six consecutive months without a full correction. Now obviously the market can move up for a year or even longer without a full correction, but the longer the rise lasts, the nearer we are to the ultimate correction.

The second item is that the PTI has moved higher for eleven out of the last twelve weeks. I've never seen a string like that before, and the figures obviously call for some kind of near-term corrective, or holding, action. No tree grows to the sky and even a powerful PTI needs rest somewhere along the line.

Frankly, it has been amazing to me to watch the PTI (on a daily basis) plod higher and higher. Even on days when the Dow was down the PTI would manage to eke out a gain. And on days when the Dow was up the PTI was adding 6 and 8 points at a clip. This constitutes upside pressure and a picture of persistent technical strength. But at best, eleven out of twelve weeks on the upside points to some kind of pause. But those betting on (or praying for) a major correction here may yet be disappointed.





I continue to draw attention to the long-rising trendline in the PTI. That trendline connects the August, October and December 1982 lows. Last week the PTI recorded a recovery high of 1497, then backed off a bit. But the PTI is still holding above the rising trendline, which now comes in at about 1465. A breaking of that trendline, and then a persistent downtrend would, of course, constitute a bearish message from the PTI. But that has NOT happened yet. In fact, up to this writing it is remarkable to see how resistant the PTI is to the downside.

Last week also saw the A-D ratio on the NYSE rise to new highs. In fact, the A-D is now at its highest level since mid-1981. This bull does not give up easily–even though much of the evidence "suggests" that a correction is overdue.

INVESTMENT POSITION: The bull is in the box and the PTI continues to hold above its rising trendline (and above its 21-week moving average). But the PTI has also been up for eleven out of the past

twelve weeks, and that spells "over-bought" for the market. So hold off on any buying plans. As of now, you should be in a position of roughly 25% gold and gold-related items, another 25% to even 30% in no-load stock funds, and the remainder in 91-day T-bills.

Many new subscribers may feel that I am too conservative. They would like to be 100% in stocks or 50% in gold. Well, I *am* conservative, but I've seen too many people wiped out by positions that drive them up the wall the first time the Dow drops 25 points. I don't like my subscribers to be "over their heads" in any position. The market will be around a long time, and (hopefully) so will you. So you don't have to make it all the first year–leave that to the boys in Las Vegas; we'll do it the slow, hard way (and the safe way). I might add that an important, new investment position will be introduced in the next report.

THING TO COME–THE SHOCK: For two years or longer I have been harping on the coming "shock of recognition." That shock will arrive when it is realized that Russia has reached a position of world military superiority. Much of my information has been obtained in conversations with my good friend, Melvyn Lippman, publisher of US Organization Chart Service, a La Jolla based organization which collects, analyzes and publishes data, information and opinions on the US military and industrial complex.

Following are a few of Mr. Lippman's current opinions, and older subscribers will note that a few of these have been expressed in these reports before. (1) There is no centralized or coordinated policy in US arms development or procurement. Many services and organizations do not know what the other services are doing. There is duplication in some cases, omission in other instances. Nor is there any central authority regarding what the US needs, where we are going militarily, or what we should do in research.

(2) Russia has a plan. That plan is undisputed world military superiority. This plan directly augments Russia's master plan to dominate the world. The massive Russian military build-up will be used to dominate world markets in Russia's attempt to show that only Communism can work on an international scale. The "war" will be fought on the economic front with Russia trying to capture world raw material markets first. The mid-East and the African continent will be prime initial targets.

(3) Whereas Russia has a master plan, the US has no plan–it only reacts. Russia does this, the US tries to counter. Russia develops a new weapon, the US debates as to whether it should build a similar (or better) weapon.

(4) The US is now falling dangerously behind in research and development for military capabilities. The Russians are surging ahead. The Russians are many "weapon systems" ahead of us in vital areas. Without research and development for new systems, there can be no useful production. Right now, states Lippman, the US is basically producing weapons for the last war (which was Vietnam). For instance, says Lippman, the naval carriers are antiques. They cost billions and can be knocked out by missiles costing a few million dollars or less. The B-1 bomber is a stop-gap plane, and it will be antiquated even before it is finally produced. The new M-1 tank will also be antique–the Russians are now in production of new tanks with flight capabilities!

(5) Lippman says that even as we talk, the span between US and Russian military capabilities widens in favor of Russia. Within two to three years or even less, says Lippman, he expects the impact of Russian military superiority to hit. I asked Lippman how it will hit. He answered, perhaps from a Russian command to Japan to "cease your military build-up!" Or perhaps Russia will say to Western Europe, "Get all US missiles out of Europe!" And Europe, terrified, will obey. At that point, the full implications of Russian military superiority will burst upon the US much as Sputnik did in 1957.

(6) Russia is investing twice as much as the US in her armed forces and three times as much in her strategic forces with the

accent on intercontinental missiles. The following statistics were given to Congress by Defense Secretary Weinberger. Stated Weinberger in an article in US News & World Report: "If the trend of Soviet expansion we have witnessed over the last 20 years is permitted to continue, the long-term consequences for the US would be disastrous."

Weinberger gave congressional panels this comparison of superpower arms output from 1974 through 1982—

	U.S.	Soviet
Tanks	6,400	17,350
Tactical aircraft	3,050	6,100
Rocket launchers	350	13,350
ICBM's	346	2,035
Major surface warships	72	85
Submarines	29	94

(7) On February 6 the *New York Times* magazine featured a fine article on Weinberger and the defense predicament written by Theodore White. Notes the article, during the Eisenhower years defense received 56% of all US expenditures while social programs received 23%. The two crossed during the Nixon years. In the last year of the Carter Administration, social programs took 52% of all expenditures while defense sank to 23.6%.

(8) The Times concludes that "the country may well be in danger 10 years from now " but we are all right today. But Lippman disagrees vehemently. He believes the US could be in danger in a year or so from now. The Russian build-up is accelerating, he says. Perhaps the most frightening statistic is this: Roughly 50% of all US money for defense goes to pay salaries and pensions. For Russia, the figure is only 14%. Thus, the great bulk of Russian money goes to hardware and research and development while half of our money goes to salaries.

(9) The politics of the battle goes on in the US. But the Russians with their dictatorship have a single purpose in mind—and that purpose is being fulfilled. Says the Times, "One could go on with the conundrums. How does a nation live with a Congress that counts more brilliant men than ever before but cannot lead, and will allow no leadership. Since Watergate, the Congress of the United States has been in revolt against its Presidency. . . ."

(10) Adding to US problems is the Pentagon set-up. Newsweek (Feb. 14) had an excellent article on this entitled, "Why the Generals Can't Command." A few excerpts are included below:

> **'Oatmeal':** Three afternoons a week, the Joint Chiefs meet in a room known as "the tank" on the E-ring of the Pentagon, ostensibly to thrash out differences among the services and determine long-term strategy. But what they produce is advice so bland—"a bowl of oatmeal" is what a one-time aide to Harold Brown calls it—that it is barely worth considering.
>
> **'Pulling Teeth':** Members of the Joint Staff labor under another handicap—a lack of data. Information regarding the capabilities and costs of weapons systems is jealously guarded by the services, which try to avoid submitting their pet projects to independent analysis. "You try to get below what they give you, and man it's like pulling teeth," says one veteran of the Joint Staff. "I won't say it's like keeping two sets of books, but to a certain extent it amounts to that." In most cases, the Joint Staff produces little more than Pablum. Former staffer Arthur Lavalle characterizes the work of the Joint Staff as "hundreds of guys throwing mud at a wall and hoping some of it sticks." Still, in some instances the Joint Staff does something more: it can be a means of keeping vital information from the civilians who run the Pentagon.

All right, what do I think (and many of these ideas were arrived at through my conversations with Lippman)? I think that we are faced with a choice of "Social Security or national security." In other words, if we are to survive as a free people, we are going to have to face the facts, face reality. We must recognize that we are in a national emergency. A lot will have to be sacrificed. So far, little has been sacrificed. We are fat and sassy, but that condition is not fated to last long.

I think that we will face some kind of shock of recognition in the period ahead and the full import of the Russian build-up will then hit the average American. At that point, the need for a massive revision in thinking about the US military will drop into place. The build-up, the US military build-up, will be absolutely mind-blowing. Economically, it will be "World War 111, but hopefully without the actual fighting." Yes, I see this situation coming, and coming fairly fast.

And I have thought to myself, is this the reason for the giant head-and-shoulders bottom in gold? And is this the reason for the huge head-and-shoulders bottom in my Primary Trend Index? Have the markets in their unconscious wisdom sensed all this? I believe they have.

Now I don't have all the answers (modest statement of the year). So when you ask me, "How is this all going to be financed?" I can only say, "How is any war financed?" You don't argue, you don't complain, your life is on the line, your country's life is on the line. You just do it! You spend, and you figure out how you're going to pay later."

And that is what I see coming up. Hundreds of billions of dollars, yes, trillions of dollars will be spent on the military as the full scope of the Russian military build-up (and the plans behind that build-up) burst upon the world.

And what do we as investors do about it? I'd say that we have already taken the first step—the position in gold. The second step is as follows. I am hereby recommending a group of 10 carefully chosen defense-oriented stocks, and my recommendation is that subscribers buy a unit of each of these 10 companies (buy 10 shares of each, or 50 shares each or multiples of 100 shares each). The stocks are: LFE (NYSE, price about 12), Moog B (ASE, about 14), Harris Corp. (NYSE, 48) Scientific Atlanta (NYSE, 18), BDM (ASE 43), Planning and Research (NYSE, 15), Dynalectron (ASE, 13), Systems and Planning (ASE 6), Bolt, Beranek & Newman (ASE 38), Tracor Inc. (NYSE, 29).

I will call this our "Defense Group" and I will keep an accounting of this group in each forthcoming report. The average price of one share of each of the ten stocks was 236 this week. In other words, if you bought 10 shares of each of these stocks the cost would be $2,360. If you bought 100 shares of each the cost would be $23,600.

Question: Russell, what about a US-Russian compromise or arms agreement? Why won't this come to pass?

Answer: You don't understand. Russia is out to prove that Communism is the wave of the future. In order to do that, Russia must defeat capitalism. What compromise? Russia is playing a winning game. Russia's moving ahead of the US, far ahead, in military capabilities. Winners don't compromise. They may stall for time, they may play cat and mouse games, but they don't compromise. You compromise either out of fairness or weakness. The Russians don't play fair, and they aren't weak. So forget about any meaningful compromise.

Question: Won't Russia be ruined by their continuing arms build-up?

Answer: The Russians have sacrificed their civilian economy for military power. Russian soldiers get about $14 a month. Their civilian economy is sparse. Russians have money, but few goods to buy. There are lines everywhere in Russia. But they are used to this, and they have been promised that things can only get better. The US is basically bloated. We have been going into debt ever since WW 11 in order to live the good life. Ultimately, I have always felt that the US consumer would have to give a lot up in order to keep freedom. What we will have to give up is money in the form of new taxes and comforts as reduced purchasing power buys us less. To put it simply, there is no way (from here on) that we are going to have both guns and butter. If we give up the guns, we are going to be Russian dominated. If we give up the butter, we are going to be unhappy. But there is no alternative–not if we want to remain free.

Question: What do the Russians want with the US? How could they dominate us? What would they do, send over a million-man police force?

Answer: The Russians don't want the US per se, and they're not going to send over anyone. The Russians want US *markets,* and they don't want any US interference when they go after these markets. The Russians want to control world raw material sources and world commerce. They know that the nation that controls the world's raw materials and commerce controls the world. The military, as far as the Russians are concerned, is their ticket to victory. Also, the Russians know that a massive military entails great sacrifice. They are betting that in peacetime, the free world will not sacrifice. And so far they have been right.

Question: Russell, what makes you and Lippman such big seers? I mean, who gave you the great insight and intuition?

Answer: These Letters are read by thousands of people and many in very high places. And I feel (obviously) very strongly about this. So I'm going to give you a very emotional answer. Lippman and I happen to be Jews. Now the Jews who are left on this earth tend to be instinctual survivors. I never asked Lippman about his family, but my father told me about mine. My forefathers were fierce Berber tribesmen in North Africa. Under Arab pressure they escaped to Spain. But during the Spanish inquisition they fled to Holland. Dissatisfied with Holland, they moved to England during the 1700's. From there they sailed to America, and one of my forefathers was Abraham Alexander, an officer in General Washington's army. My family fought during the Civil war, my father was a Navy flyer during World War 1 and I was an Air Force bombardier during WW 11. We have a long history of looking for and fighting for freedom. And we can smell danger ten miles away or a thousand miles away. I believe I have what I call "survival instincts." For instance, my subscribers may not have caught all the bull moves in this or any other market, but they have never lost money during any bear market of the last 25 years.

I firmly believe that what I have written about the Russian military build-up is the correct view, and I don't care what any Congressman or Senator or newspaper man says. Our country is moving into very difficult times. I believe it, and I'm thinking that you, my subscribers, better believe it.

Oh yes, here's a little clip (LA Times) that I picked out of today's paper. Interesting reading.

> **WASHINGTON—The Soviet Union recently supplied Syria with satellite communication equipment that, in conjunction with the new Soviet air defense network in Syria, could allow Soviet generals in Moscow to exercise direct "hands-on" control of Mideast air battles, U.S. intelligence sources told The Times on Thursday.**

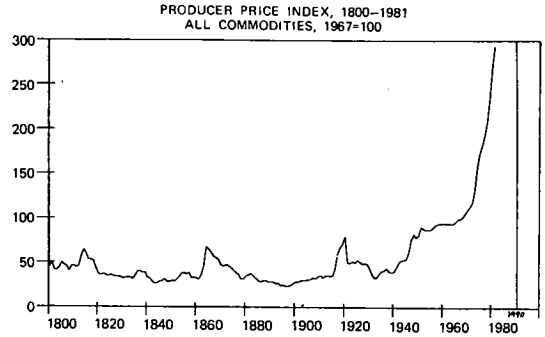
INFLATION? One thought keeps coming back to haunt me. And it's this: everyone "in the know" is betting on a resurgence of inflation. For January, M-2 rose at a 30% rate, and isn't that a guaranteed formula for re-inflation? And a secret voice inside me says, "Yes, it's the formula for inflation, but it's not guaranteed." Obviously, the Fed is worried sick. They have to be to let the money supply careen into the wild blue yonder the way they're doing. And I have the feeling that the Fed would let it go even further if they could get away with it without scaring Wall Street and the bond market to death.

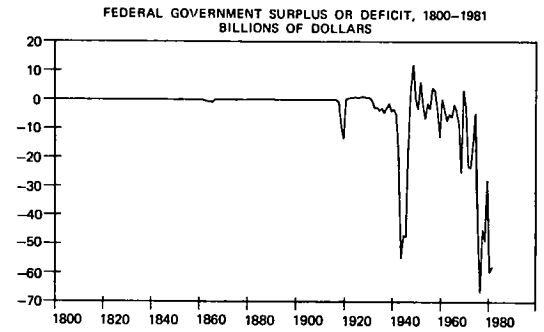
If this were 1950 or 1960 (with the money supply gushing as it is) interest rates would be collapsing and you'd be getting a 2% yield on your T-bills instead of today's 8.25%. But it's not 1950 or 1960; it's 1983 and the world is awash with debt. You can see it plainly enough here in San Diego. The City has stopped hiring because it is running a budget deficit of $5 million, the County of San Diego is strapped and facing deficits and the State of California will be paying its creditors in I.O.U.'s next week because it has run out of money and is facing a $1.5 billion deficit.

The page 5 chart (thanks to Doug Casey) shows that the Federal Government was balancing its budgets beautifully–until around 1940. Then came World War 11 and Keynesianism and the deficits went wild. And so did inflation. So isn't it obvious–deficits produce inflation? Yes it is obvious, but from here on I am just a little skeptical of the obvious. I'm skeptical because we now have something we've never had before; bone-jarring, crushing, mountains of debt. That debt has to be serviced come hell or high water, and servicing that ever-rising mountain of debt costs more and more money. And that's *deflationary.*

Now we have $5.5 trillion in total debt in the US and Lord knows how much debt outside the US. And the world economy is slowing down. A slowdown in a debt free world produces a recession. A slowdown in a debt-ridden world is liable to produce a depression–and deflation. And that, in a nutshell, is what worries Richard Russell.

Yes, the obvious conclusion is that a 30% growth in M-2 is going to fire up inflation and send the markets to the moon. But the less obvious thought is that we're over our heads in debt, and that anything *within reason* that the Fed is liable to do–is not going to turn this recession around. And in the meantime, the possibility of a deflationary collapse draws nearer.

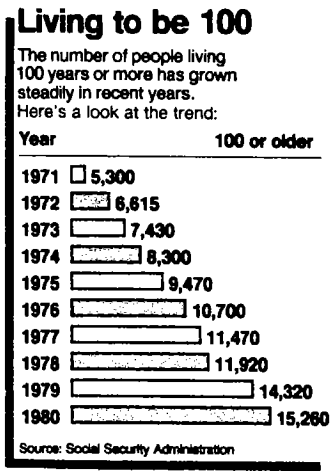




COURTESY MANUFACTURERS HANOVER TRUST

Where to watch in the markets: watch gold, silver and the commodities. If inflation is to return, then those items should take off. So far, what we've been seeing in precious metals could simply be corrections of the 1980-81 crash (although gold above 600 would start to look inflationary). What we've seen in the rest of the commodities is nothing much at all. They're still "dead in the water."

NOTES & QUOTES: A few years ago I wrote a piece expressing my opinion that men and women should normally live to be 100, assuming they were in fine psychological and physical shape (of course, most of us are not–but we could be). At any rate, more and more people are living to be 100, as this chart from USA Today shows. Interestingly, 75% of the centenarians live in urban areas while two-thirds of them are women. If you're a woman in the city, you're ahead of the game!



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Is inflation over? I was looking over some auto statistics, and you wouldn't know inflation had died from these figures. The price of a Ford Mustang in 1979 was $4,494. In 1983 the Mustang was $7,264–up 61%. The price of a Toyota Corolla was $3,748 in 1979. In 1983 it was $5,448–up 45%. The Cadillac Coupe DeVille was $11,799 in 1979. In 1983 it was $15,970–up 35%.

Speaking of autos, the following are strictly Russell options: The Toyota Tercel is the top bargain "cheap transportation" vehicle. I bought one for my 19-year old daughter, Betsy, and it was a winner. The car is a real gas-saver, although it is a bit low on power. I recently bought a Datsun Maxima for myself. The car costs around $12,000 and is the top of the Datsun line. I love it, and (as with all Japanese cars) EVERYTHING on this car works! I purchased the diesel model, which I also like (diesels have fewer working parts than gas engines and the diesels, therefore, tend to last longer).

My wife Paula just boughta Jaguar XJ6, and this, to my mind, is the best looking and most beautifully appointed car on the road (except for the super-priced Rolls). Jaguars, in the past, had all kinds of trouble with their electrical system, but the new Jaguars reputedly are vastly improved. The word is out, and our neighbor (just back from Germany) tells us that the "Yag-wars" are now a big seller in Germany (where people are getting bored with Mercedes). Jaguar sales have increased for the last 22 months, while the industry was slumping.

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The Feb. 7 New York Magazine has a great piece by food critic Gael Greene in which she ranks "The Great French Restaurants of New York." The top five are Lutece, Le Cirque, Cote Basque, Maurice, Le Perigord Park, Le Perigord. And here I am in San Diego, a city of almost one million (it's now larger than San Francisco) and we don't have a single superb French restaurant. If some great chef is reading this, come West, friend. The field is ripe. I think San Diego is ready for its first great French restaurant (we've got thousands of mediocre restaurants, so if you're not an artist don't bother). Think of it, a business with no competition in a city of a million which boasts the best weather in the nation.

LATE NOTES: The PTI has been leading this market up ever since last August. Evidently, nothing has changed. The PTI started the week at a new high of 1498. This is a new recovery high, and it's the highest PTI reading since the record high of 1510 touched in June, 1981. The market itself appears a bit ragged, it's fatigued, but as I've written so many times–it pays to STAY on the right side of the PTI. The A-D ratio seems to be following the lead of the PTI. The A-D hit a recovery high last week, and it keeps inching and chugging northward. It's a market that's tired but does not want to go down.

MOVING AVERAGES: I am incorporating the moving average box as a feature of each report. I think this box should be of real help to subscribers. The bullish mode would show the current price above the short-term MA, the short-term MA above the intermediate-term MA, and the intermediate above the

	Dow	PTI	Gold
Current	1093	1498	503
5-wk MA	1078		497
13-wk MA	1054		474
50-wk MA	959		425
3-wk MA		1488	
8-wk MA		1464	
21-wk MA		1414	

long-term MA. All three items, gold, the Dow and the PTI are currently in the full bullish mode as far as their current price in relation to the three MA's.

GOLD: The US and the world are trying desperately to reflate. The world banking organizations, the International Monetary Fund, the Bank for International Settlements, the World Bank, they ALL want more money so they can make more and bigger loans to the down-and-out countries. And the question on my mind is–will reflation take place? Can they bring it off? Or are the deflationary pressures of hundreds of billions of dollars in loans just too much for the world? Is the world past the point of being able to reflate?

No one knows the answer to that one, but believe me, it is one of the most critical questions of 1983. There are places we can look, however, and gold is the chief place. Two other areas are commodities (very sensitive to inflation) and oil. The oil glut has fragmented OPEC, and the spot price of oil is considerably below the so-called "official OPEC price". As for commodities, the CRB Futures Index has been bouncing around the 220-245 area for many weeks. So far, no breakout of the 245 level, even though everyone and his brother is predicting a big bull market in commodities.

I don't think we have been seeing speculative buying in gold. I think the buying so far has come from "big money," money that wants to hedge (in both silver and gold) against a possible default in the banking system. Gold and silver have been used as insurance policies. If the banking system goes under, "we still have real money–gold."

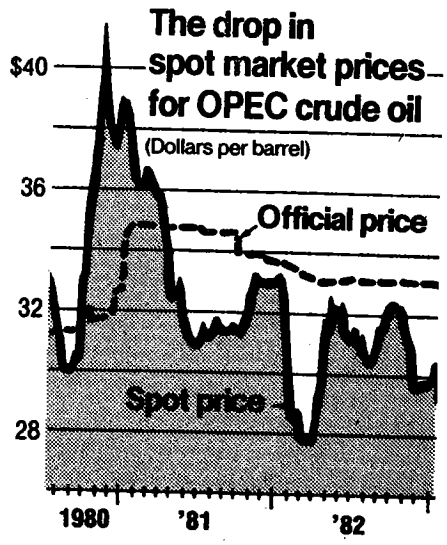
I know that some of my subscribers are holding gold because they consider it a great speculation. But the picture is a lot bigger than that. My own opinion is, "Lord help us if gold can't remain bullish in the period ahead." A breakdown in the sensitive "gold barometer" would be telling us that the great reflation attempt has failed, that they couldn't bring it off. In that case we would be facing a world depression, a probable massive and wholesale debt default, and undoubtedly the worst banking crisis of modern times.

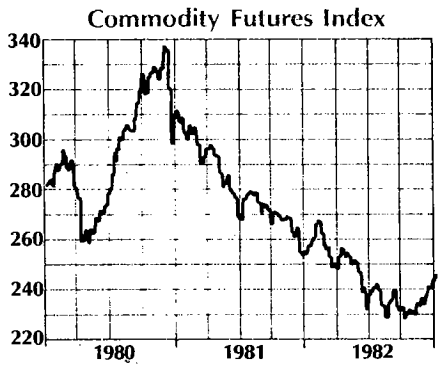
"But Russell," I'm asked, "If the banking system starts to fall apart, won't people rush into gold? Won't gold roar to undreamed of heights if the debt collapses?"

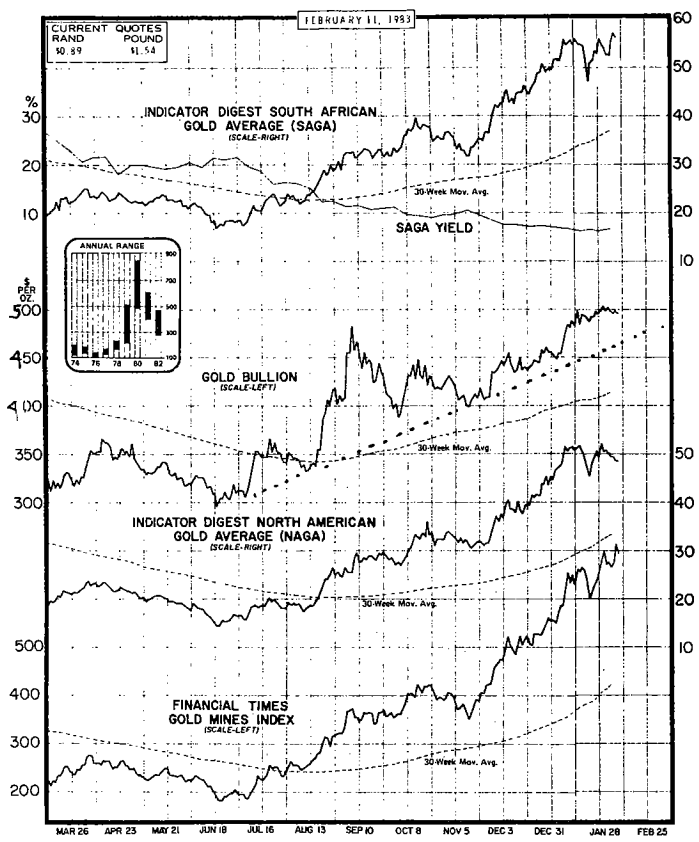
There is no absolute answer to that one. Nobody on this planet knows, in the event of banking defaults, whether people will rush into gold, or whether people will dump everything including gold in a mad, headlong dash to get liquid. Remember, in the US you buy hamburgers and you pay off debt–with dollars. So if icy fear overtakes the country, we don't know whether dollars or gold (or perhaps both) would be the saviors of the day.

Technically, gold has been trying to establish itself above the critical 500 level, and if it can do this (hold stubbornly above 500 for a few weeks or longer) this will be an impressive achievement. Once holding above 500, I would expect a continued upward "creep" with gold perhaps hitting the middle 500's by April to June.

This chart (by Indicator Digest, Palisades Pk, NJ 07650) presents an interesting picture of the whole gold complex. Note that the rising trendline on gold comes in (on this arithmetic chart) at about 475.







NEXT MAILING: March 9